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SEC Completes JOBS Act Rulemaking with Amendments to Exchange Act Registration Rules

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The SEC recently adopted rules implementing Title V and Title VI of the Jumpstart Our Business Startups Act (the “JOBS Act”) and Title LXXXV of the Fixing America’s Surface Transportation Act (the “FAST Act”). Title V and Title VI of the JOBS Act, in relevant part, amended Sections 12(g) and 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”) to adjust the thresholds for registration, termination of registration and suspension of reporting, while Title LXXXV of the FAST Act remedied the omission from the JOBS Act of savings and loan holding companies in the revised thresholds for registration, termination of registration and suspension of reporting. The SEC’s implementing rules under the JOBS Act were originally proposed in December 2014, and the SEC received 11 comments letters that generally supported the proposals. With the adoption of these rule changes, the SEC has completed all rulemaking mandated by the JOBS Act. The amended rules reflect the new, higher registration, termination of registration and suspension of reporting thresholds. The amendments also establish a non-exclusive safe harbor for issuers when determining if securities held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act may be excluded when determining whether they are required to register under Exchange Act Section 12(g)(1).

INCREASED THRESHOLDS FOR REGISTRATION AND REPORTING OBLIGATIONS

Registration of Securities

When registration is required. Exchange Act Section 12(g), as amended by the JOBS Act and the FAST Act, generally requires that, subject to certain exceptions, an issuer must register a class of equity securities (other than exempted securities) with the SEC if, on the last day of its fiscal year, the issuer has total assets of more than \$10 million and the class of equity securities is “held of record” by either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors; or, if the issuer is a bank, a bank holding company (as defined in Section 2 of the Bank Holding Company Act of 1956) or savings and loan holding company (as defined in Section 10 of the Home Owners’ Loan Act), the issuer must register a class of equity securities (other than exempted securities) with the SEC if, on the last day of its fiscal year, the issuer has total assets of more than \$10 million and the class of equity securities is “held of record” by 2,000 or more persons.

Exchange Act Rule 12g-1 provides an exemption from the Section 12(g) registration requirements. As amended, Rule 12g-1 now provides that an issuer is not required to register a class of equity securities pursuant to Section 12(g)(1) if, on the last day of its most recent fiscal year:

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- the issuer had total assets not exceeding \$10 million; or
- the class of equity securities was “held of record” by fewer than:
 - 2,000 persons; or
 - 500 persons who are not accredited investors (as defined in Rule 501(a) of the Securities Act of 1933 (the “Securities Act”) and as determined as of such day, rather than at the time of the sale of the securities).

In the case of a bank, a savings and loan holding company, or a bank holding company, Rule 12g-1 now provides that registration of a class of equity securities is not required if the class was “held of record” by fewer than 2,000 persons.

If an issuer cannot meet any of these conditions, Section 12(g)(1), as amended, requires that an issuer must register a class of equity securities (other than exempted securities) within 120 days after its fiscal year end.

Entities exempt from registration under Section 12(g). Section 12(g)(2) provides an exemption from the Section 12(g) registration requirements for, among other categories, any security listed and registered on a national securities exchange and any security issued by a registered investment company. Rule 12g-2 addresses securities deemed to be registered pursuant to Section 12(g)(1) upon termination of the exemptions specified in Section 12(g)(2). As amended, Rule 12g-2 establishes a 300-person threshold for such a class of securities to be registered under Section 12(g), except in the case of a bank, a bank holding company or savings and loan holding company, in which case the rule specifies a 1,200-person registration threshold.

Registration for successor issuers. Rule 12g-3, as amended, which addresses the 300-person threshold for the registration of securities of successor issuers, similarly provides a 1,200-person registration threshold for a bank, a savings and loan holding company or bank holding company.

Termination of Registration

Revised Rule 12g-4(a) provides that termination of registration under Section 12(g) shall take effect in 90 days, or such shorter period as the Commission determines, after the issuer certifies on Form 15 that the class of securities is held of record by fewer than:

- 300 persons;
- 1,200 persons in the case of a bank, a savings and loan holding company or a bank holding company; or
- 500 persons where the total assets of the issuer have not exceeded \$10 million on the last day of each of the preceding three years.

Termination of Reporting Obligations

Revised Rule 12h-3 provides that the duty to file current and periodic reports under Section 13(a) pursuant to Section 15(d) for that class of securities is suspended *immediately* upon the filing of a certification on Form 15, provided that:

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- With respect to holders of record, the issuer has fewer than:
 - 300 holders of record,
 - 500 holders of record where the issuer's total assets have not exceeded \$10 million on the last day of each of the preceding three years, or
 - in the case of a bank, a savings and loan holding company or bank holding company, 1,200 holders of record;
- the issuer has filed its Section 13(a) reports for the most recent three completed fiscal years, and for the portion of the year immediately preceding the date of filing the Form 15 or the period since the issuer became subject to the reporting obligation; and
- a registration statement has not become effective or was required to be updated pursuant to Exchange Act Section 10(a)(3) during the fiscal year.

As a result of the changes to Rule 12g-4(a), banks, savings and loan holding companies and bank holding companies are able to terminate registration of a class of securities and suspend *immediately* their duty to file current and periodic reports upon filing a certification on Form 15 at the 1,200 person threshold.

INCREASED THRESHOLD FOR ACCREDITED INVESTORS

In order to rely on the new, higher threshold for Section 12(g) registration established by the JOBS Act, an issuer will need to be able to determine which of its record holders are "accredited investors." Rule 12g-1 now provides that the term "accredited investor" for purposes of Section 12(g)(1) is defined in Securities Act Rule 501(a); however, the "accredited investor" determination for these purposes must be made as of the last day of the issuer's most recent fiscal year, rather than at the time of the sale of the securities.

Rule 501(a) provides that an "accredited investor" is any person who comes within one or more of the categories of investors specified therein, or whom the issuer reasonably believes comes within any such category. Whether the issuer has a reasonable belief depends on the particular facts and circumstances surrounding the determination. Under amended Rule 12g-1, an issuer will need to determine, based on facts and circumstances, whether prior information provides a basis for a reasonable belief that the security holder continues to be an accredited investor as of the last day of the fiscal year.

Although some commenters requested guidance on making the accredited investor determination in the Section 12(g) context or a safe harbor relating to the determination, the SEC did not provide any additional guidance and the final rules did not include a safe harbor. In the adopting release for the final rules, the SEC noted that a safe harbor could become a *de facto* minimum standard, and the SEC believes that requiring issuers to consider their particular facts and circumstances in establishing a reasonable basis for their determination provides issuers with appropriate flexibility for making the determination.

DEFINITION OF "HELD OF RECORD"

As detailed above, for purposes of determining whether an issuer is subject to the provisions of Section 12(g), an issuer looks to the number of "holders of record" of its securities. The definition of "held of record" specified in

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Rule 12g5-1 has been amended to provide that when determining whether an issuer is required to register a class of equity securities with the SEC pursuant to Exchange Act Section 12(g)(1), an issuer may exclude securities that are:

- held by persons who received the securities pursuant to an employee compensation plan in transactions exempt from, or not subject to, the registration requirements of Section 5 of the Securities Act (now Rule 12g5-1(a)(8)(i)(A)); or
- held by persons who received the securities in a transaction exempt from, or not subject to, the registration requirements of Section 5 of the Securities Act from this issuer, a predecessor of the issuer or an acquired company “in substitution or exchange for” excludable securities under Rule 12g5-1(a)(8)(i)(A), as long as the persons were eligible to receive securities pursuant to Rule 701(c) at the time the excludable securities were originally issued to them (now Rule 12g5-1(a)(8)(i)(B)).

New Rule 12g5-1(a)(8)(i)(A) encompasses securities received in transactions exempt from, or not subject to, the registration requirements of Section 5. Such transactions include transactions that did not involve a sale of securities within the meaning of Section 2(a)(3) of the Securities Act, as well as transactions involving exempt securities, such as sales of securities made pursuant to Section 3 of the Securities Act.

New Rule 12g5-1(a)(8)(i)(B) provides relief in the context of business combinations, encompassing securities held by former employees of the issuer or its predecessors. The language used by the SEC—“in substitution or exchange for”—is intended to cover the various methods of how new securities may be received in place of existing securities held prior to a business combination, such as upon conversion or exercise. Revised Rule 12g5-1(a)(8)(i)(B) also permits securities to be excluded if they were received by former employees in an exempt transaction in substitution or exchange for excludable securities, where the former employees were eligible under Rule 701(c) to receive the original securities at the time of issuance.

In addition, as part of the amendments to Regulation A, the SEC adopted a new Rule 12g5-1(a)(7) to provide a conditional exemption to the definition of “held of record” for securities issued in Tier 2 Regulation A offerings.

Securities Received Pursuant to an “Employee Compensation Plan”

Section 12(g)(5), as amended by the JOBS Act, provides that the definition of “held of record” shall not include securities held by persons who received them pursuant to an “employee compensation plan” in transactions exempted from the registration requirements of Section 5 of the Securities Act. This provision, which was substantially broader than the SEC’s existing rules exempting compensatory employee stock options from Section 12(g) registration, does not define the term “employee compensation plan.” As amended, Rule 12g5-1 establishes a non-exclusive safe harbor that relies on the current definition of “compensatory benefit plan” in Rule 701 and the conditions in Rule 701(c).

By not defining the term “employee compensation plan,” and providing for a non-exclusive safe harbor, the SEC noted that issuers will have appropriate flexibility to make a principles-based determination about securities received as employee compensation when determining their holders of record under Section 12(g)(5), as well as the added certainty of a safe harbor. In addition, developing a new definition for “employee compensation plan”

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could result in needless complexity and create potential conflicts with the current definitions of “compensatory benefit plan” and “employee benefit plan.”

By its express terms, this new statutory exclusion applies solely for purposes of determining whether an issuer is required to register a class of equity securities under the Exchange Act pursuant to Section 12(g)(1), and does not apply to a determination of whether such registration may be terminated or suspended.

Non-Exclusive Safe Harbor for Determining Holders of Record

The JOBS Act directed the SEC to establish a safe harbor in Rule 12g5-1 that issuers can rely on when determining if securities held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act may be excluded when calculating the number of holders of record of a class of equity securities for purposes of determining the issuer’s registration obligation under Section 12(g)(1).

The final rules amended Rule 12g5-1(a)(8) to provide a non-exclusive safe harbor. The safe harbor provides that:

- an issuer may deem a person to have received the securities pursuant to an employee compensation plan if such plan and the person who received the securities pursuant to the plan met the plan and participant conditions of Securities Act Rule 701(c); and
- an issuer may, solely for the purposes of Section 12(g), deem the securities to have been issued in a transaction exempt from, or not subject to, the registration requirements of Section 5 of the Securities Act if the issuer had a reasonable belief at the time of the issuance that the securities were issued in such a transaction.

The SEC noted in the adopting release that using the conditions of Rule 701(c) to structure the employee compensation plan safe harbor for the determination that a person received the securities pursuant to an employee compensation plan allows issuers to apply well understood principles of an existing Securities Act exemption to the new Exchange Act registration determination created by the JOBS Act, facilitating compliance and simplifying recordkeeping.

Rule 701 exempts from Securities Act registration offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation. Rule 701(c) limits this exemption to offers and sales of securities under a written compensatory benefit plan established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer’s parent, for the participation of their employees, directors, general partners, trustees, officers, or consultants and advisors.

Transferees. The safe harbor provided in amended Rule 12g5-1(a)(8) is available for the plan participants enumerated in Rule 701(c), including employees, directors, general partners, trustees, officers and certain consultants and advisors. The safe harbor also is available for permitted family member transferees with respect to securities issued pursuant to a plan that are acquired by gift or domestic relations order from plan participants, or such securities acquired by permitted family member transferees in connection with options transferred to them by the plan participant through gifts or domestic relations orders. Because the safe harbor is limited to holders who are persons specified in Rule 701(c), once these persons subsequently transfer the securities to holders not

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specified in Rule 701(c), whether or not for value, the securities must be counted as held of record by the transferee for purposes of determining whether the issuer is subject to the registration and reporting requirements of Exchange Act Section 12(g)(1).

The safe harbor is available for holders of securities received in other employee compensation plan transactions exempted from, or not subject to, the registration requirements of Section 5 of the Securities Act, such as securities issued in reliance on Securities Act Section 4(a)(2), Regulation A, Regulation D, or Regulation S under the Securities Act, that also meet the conditions of Rule 701(c).

Foreign Private Issuers

Under the final rules, foreign private issuers may rely on Rule 12g5-1(a)(8) when making their determination of the number of U.S. resident holders under Rule 12g3-2(a). Under Rule 12g3-2(a), foreign private issuers that meet the asset and shareholder threshold for registration under Section 12(g) are exempt from registering any class of securities under that Section if the class of securities is held by fewer than 300 holders resident in the United States. For purposes of determining whether this threshold is met, Rule 12g3-2(a)(1) specifies that the method shall be as provided in Exchange Act Rule 12g5-1, except that securities held of record by brokers, dealers, banks and nominees for the accounts of customers resident in the United States shall be counted as held by the number of separate accounts for which the securities are held.

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